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The International Investment Position of the United States

Sarah A. Hooker

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- This report analyzes the net international investment position of the United States in the years 1983-1986. Using the Department of Commerce framework, which is the full balance sheet net international investment position, this analysis involves a clarification of the term "debtor" and a reevaluation of some components of the net international investment position. In addition to refining the definition of debtor, this report analyzes the components of the international investment position. The results of this analysis are (1) elimination of full balance debtor status of the United States in the years 1985 and 1986, (2) reduction of the financial net in all four years, (3) movement of the nondebt net from debtor to creditor status in all four years, and (4) no significant impact on the rate of change of the net international investment position or of its subbalance nets. The report briefly discusses the forces behind the decline in the net international investment position and determines that it should not necessarily be deemed a deterioration because of the positive economic effects of capital inflows.

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The International Investment Position of the United States

Sarah A. Hooker

October 1988

Prepared for the
Office of the Secretary of Defense

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PREFACE

This study of the international investment position of the United States was prepared during the period from June to August 1987, when the author, a graduate student and teaching assistant in economics at the University of Michigan, was a summer intern at The RAND Corporation.

The summer internship program is designed to give some of the "best and brightest" graduate students a brief exposure to RAND by working on either an ongoing RAND research project or one that is specifically formulated for them. This study is an example of the latter type.

Popular beliefs and conventional wisdom about the international investment position of the United States, and its turn for the worse in recent years, are widespread. Moreover, such beliefs are often quite influential in shaping the expectations and behavior of policymakers, as well as publics, at home and abroad. The results can affect the calculations of other countries and their relationships with the United States. Moreover, these beliefs quite often spring from oversimplified, if not simplistic, analysis based on partial, if not misleading, data.

These considerations lay behind my suggestion to the author, upon her arrival at RAND, that she explore and refine both data and analysis bearing on whether, when, and to what extent the United States has become a "debtor country," as well as the different meanings and wide-ranging estimates that can be attached to the term. Her study has broken new ground and produced results that are both significant and novel, and should be of interest to policymakers and staff members of the Defense Department, the State Department, and the National Security Council.

This work has been done as part of RAND's research program in *International Economic Policy* under RAND's National Defense Research Institute, a Federally Funded Research and Development Center supported by the Office of the Secretary of Defense.

Charles Wolf, Jr.
Director
International Economic Policy Program

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SUMMARY

The definition of the term "debtor" adopted for the United States has been the full balance sheet net international investment position presented annually by the Department of Commerce (DOC) since that figure first became negative in 1985. The net international investment position is the difference between all U.S. assets abroad and all foreign assets held in the United States. Thus, if foreign holdings in the United States are larger than U.S. holdings in the rest of the world, the net position is negative. According to DOC reports, debtor status, i.e., a negative net balance, occurred first in 1985 and then again in 1986. The position is reduced, or declines, when foreign holdings in the United States grow at a faster rate than U.S. holdings abroad. The term "deterioration" is often used to describe a change of this kind. However, because of its negative connotations, which are not necessarily warranted, it will not be used in this report.

This report analyzes the net international investment position of the United States in the years 1983-1986. Using the DOC framework, the analysis will involve a clarification of the term "debtor" and a reevaluation of some components of the net international investment position.

The DOC full balance sheet of assets and liabilities can logically be divided into two sub-balances: nondebt and financial. The distinction relates to the servicing returns/burden of assets/liabilities. Specifically, the nondebt balance includes equities, real estate, and direct investment. These assets/liabilities carry variable income/payments. The financial balance, on the other hand, involves assets/liabilities with predetermined non-zero servicing returns/burdens. Two motives lie behind this refinement of the "debtor" terminology. First, equities, real estate, and direct investment represent ownership as opposed to debt per se. Second, using the DOC presentation, comparisons have been made between the debts of the United States and less developed countries (LDCs). However, the definition of debt used for the LDCs is closer to the financial net than to the full balance net.

In addition to refining the definition of debtor, this report analyzes the calculation of the components of the international investment position. This was motivated by the desire to bring all components of the asset/liability position up to market value. Specifically, direct investment and U.S. Official Reserve gold holdings are maintained at book

and official value, respectively, in the DOC accounts. Furthermore, in the wake of the 1982 LDC debt crisis, it is appropriate to adjust the value of U.S. financial institutions' claims on foreigners.

In reference to the calculation of direct investment, both foreign direct investment in the United States and U.S. direct investment abroad are adjusted. The direct investment figures are revalued through the U.S. GNP implicit price deflator. With respect to gold, two alternative adjustments are considered. First, the official gold of the United States is revalued using a market price of gold (approximately \$380 per fine troy ounce in the time period considered) as opposed to the official price of gold (\$42.22 per fine troy ounce). Second, and alternatively, the official gold balance is removed from the net international investment position because its presence is the result of a monetary role no longer maintained. Finally, U.S. bank and non-bank claims on 13 developing countries are revalued using secondary debt market valuations.

The results of this analysis are the following: (1) elimination of full balance debtor status of the United States in the years 1985 and 1986, (2) reduction of the financial net in all four years, (3) movement of the nondebt net from debtor to creditor status in all four years, and (4) no significant impact on the rate of change of the net international investment position or of its sub-balance nets.

Regarding item (1), the full balance results indicate that values range for the net international investment position; the range depends on the definitions and adjustments made. The U.S. net international investment position in 1985 ranges from net debtor of \$111.9 billion to net creditor of \$177.7 billion. For 1986, it ranges from net debtor of \$263.6 billion to net creditor of \$49.8 billion. However, the rate of change of the net international investment position is not significantly affected by the recalculation.

Regarding item (2), the negative financial net position is made larger in absolute value by the readjustment. This narrow definition of debt turned negative for the first time in 1971. However, it became positive again in the early 1980s. For the year 1983, the financial net ranged from \$77.9 billion to \$38.3 billion; in 1984, from \$12.8 billion to negative \$26.8 billion; in 1985, from negative \$83.8 billion to negative \$121.8 billion; and finally, in 1986, from negative \$208.7 billion to negative \$246.2 billion. Again, the rate of change is not significantly affected by the recalculation.

Regarding item (3), the nondebt net is significantly increased by the adjustment. Thus it moves from a negative net (net debtor) to a positive net (net creditor) in all four years. This result was expected because the book value of older investments diverges more substan-

tially from the market value of those investments than the book value of newer investments diverges from their market value. Thus, newer foreign investment in the United States is closer to its market value and experienced smaller adjustments compared with older U.S. investments abroad. The average magnitude of the change in the net non-debt position is approximately \$260 billion.

The study considers analysis limitations and suggests further extensions. In particular, key concerns in calculating the net international investment position are (a) limitations on the definition of U.S. bank and (b) the issue of the inclusion of international banking facilities located in the United States. The study also addresses the issue of the inclusion of the balance of payment statistical discrepancy. The DOC and adjusted nets are recalculated assuming that the balance of payments statistical discrepancy represents a capital account rather than a current account miscalculation. This calculation, assuming that the statistical discrepancy represents unrecorded capital flows, reduced the net international investment position.

The report briefly discusses the forces behind the decline in the net international investment position and determines that it should not necessarily be deemed a deterioration. A decline in the net international investment position simply indicates *faster growth in foreigners' assets* in the United States than in U.S. assets abroad. The composition of the position as well as the direction of change must be considered.

Finally, the study addresses, and puts into perspective, concerns voiced in the popular press over the similarity of the debtor position of the United States (using DOC numbers) to that of the LDCs, the possible decline in the U.S. standard of living, and the vulnerability of the United States to foreigners' whims.

In reference to the first concern, the comparison is flawed. Different definitions of debtor are used, and the ability to repay differs dramatically. The United States will not run into the LDC type of exchange crisis because U.S. liabilities are denominated in its own currency, dollars. Finally, the level of debt compared with the size of the economy represents a smaller percentage in the United States than in the LDCs.

In reference to the second concern—that sending dollars overseas reduces the U.S. standard of living—it should be noted that our standard of living is measured by the amount of goods and services consumed, not by the number of dollars kept in the United States. Thus, as more dollars are sent overseas to purchase goods and services, the standard of living is maintained or improved. The U.S. standard of living will fall when it can no longer send dollars overseas.

Finally, the mobility of capital is not determined by its nationality. Investors in the United States can move investment overseas as easily as foreign investors can; i.e., both U.S. and foreign investors have the potential to cause destabilization. Thus, fear of the vagaries of foreigners in particular is unfounded.

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I would like to thank Charles Wolf, Jr., of The RAND Corporation for his creation of this project and assistance and guidance in carrying it out. In addition, comments and suggestions from RAND economists C. R. Neu, Michael Kennedy, and Benjamin Zycher greatly facilitated my research and understanding of the issues and calculations involved. Russell Scholl and Harland King of the Department of Commerce were extremely patient and helpful in answering my questions concerning Department of Commerce data. Thanks also to John Wilson of the Board of Governors of the Federal Reserve System for his assistance.

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I. INTRODUCTION

On June 23, 1986, the Department of Commerce (DOC) announced that in 1985 the United States had a negative net international investment position. This was the first time since 1919 that the net international investment position was negative. The popular press noted this announcement and concluded that such a position made the United States a "debtor" nation. Thus, headlines abounded declaring the United States the world's largest debtor. In 1987, the DOC announced that the negative position grew by more than 100 percent in 1986. However, the DOC announcement that "the net investment position is a rough indicator, rather than a precise statistical measure, and should be interpreted with caution"¹ was overlooked.

This report considers the U.S. "debtor" position. The motivation behind the study is to clarify what is meant by "debtor." Refining its definition and the definitions of its components demonstrates that the net international investment position is a rough figure. Specifically, while the direction of the change in the U.S. position is clear,² it is not certain that the United States became a debtor nation in 1985 (or even in 1986). Furthermore, although the negative net international investment position has attracted a great deal of attention, three additional issues are important: (1) the direction of change in the position, (2) the rate of change in the position, and (3) the composition of the position.

The problem of defining "debtor" has three dimensions. The first dimension involves the data used in compiling assets and liabilities. The second involves the selection of the data to be included. In particular, the definitions of the components for the asset/liability sheet must be specified.

The difference between the first and second dimension can be seen by example. Suppose two surveys gather the same data. If the quality of the data is limited, for example, both surveys will be affected. This relates to the first dimension. However, when using the data both surveys need not choose the same elements or compile them in the same

¹Russell B. Scholl, "The International Investment Position of the United States in 1986," *Survey of Current Business*, June 1987, p. 38.

²A "reduction" or "decline" in the net position occurs when the figure moves from \$88.5 billion to \$4.4 billion as the DOC net did between 1983 and 1984, or when it moves from negative \$111.9 billion to negative \$263.6 billion as it did between 1985 and 1986. Alternatively, an "increase" or "improvement" in the position occurs when the net moves from \$4.4 billion to \$277.1 billion as the adjusted net did in 1985.

manner. For example, in the definition of U.S. bank, it is possible to include branches of foreign banks located in the United States as domestic banks. Alternatively, these branches could be counted as foreign. The composition of the definitions relates to the second dimension.

Finally, the third dimension is the selection of the components to be counted as assets and liabilities in the balance sheet. This could be called the format or the framework of the definition of debtor. Continuing with the example, this dimension relates to the question of whether U.S. banks should be included in the presentation.

This study will begin with the DOC data, definitions, and framework. First, the data will be adjusted, then the impact of the adjustments within the DOC presentation will be discussed. Moving away from the DOC framework, the definition of "debtor" will be narrowed from the full balance approach of the DOC net international investment position to "financial net." The financial net is obtained by removing equities, direct investment, and gold from the full balance. It aims to show the net position in reference to assets and liabilities with predetermined servicing burdens.³ The financial net represents a truer "debt" balance because it excludes those components of the full balance which represent ownership, not debt per se. The excluded elements have variable payments or returns, not predetermined ones.

Although the definitions of the components will be discussed, this study will not modify them. This is not to suggest that their modification would have no impact; indeed, it would. Thus, Sec. V suggests component changes that might prove interesting.

Finally, the issues that have arisen as a result of the announced debtor status are presented. The forces behind the decline in the full balance net are analyzed in an attempt to determine the extent to which the fall represents a decline or a deterioration. The concerns brought up by the popular press are addressed. Although policy prescriptions are not given, Sec. VI briefly discusses questions that should be considered.

³This predetermined servicing burden could be characterized by a fixed interest rate or by a rate that is a stochastic function of other rates. Thus, although the payments/receipts themselves may be variable, the formula for their calculation is specified and the servicing payments/receipts are non-zero.

II. THE DATA

The Department of Commerce publishes the international investment position of the United States annually in the June issue of *Survey of Current Business*. For example, the June 1987 issue reports the revised numbers for 1985 and the preliminary numbers for 1986. The international investment table published there is reproduced here in Table 1.¹ The annual August issue includes a more detailed breakdown of the direct investment component of the position.² Technical notes and footnotes in the tables clarify some points on the data. The June 1978 issue also contains an article on the definitions of the categories.

These DOC reports are based on Bureau of Economic Analysis (BEA) data, and they give year-end totals as well as international flows. The International Monetary Fund (IMF) also publishes a *Balance of Payments Manual*, which defines guidelines for the categories. Finally, one can call the DOC itself and simply ask for clarification.

Additional information on some components of the international investment position of the United States, as presented by the DOC, are given in the *Treasury Bulletin*.³ The Capital Movements section in the annual March issues of the *Treasury Bulletin* contains a detailed breakdown of U.S. bank and nonbank claims and liabilities. Total claims and liabilities are disaggregated by country and type, and by the currency in which the claim or liability is denominated. The categories are similar to those of the DOC, and the two data sources are basically consistent with each other.⁴ The IMF's *International Financial Statistics* is another source. For most countries, it reports U.S. liabilities to the country (line 9a.d) and U.S. claims on the country (line 9b.d). The claims reported in line 9a.d are also reported in the annual March issues of the *Treasury Bulletin* Capital Movements section, Table CM-II-2.⁵

A further source of data on the international assets and liabilities of the United States and international transactions is the *Federal Reserve*

¹Russell B. Scholl, "The International Investment Position of the United States in 1986," *Survey of Current Business*, June 1987, Table 1, p. 39.

²For example, see "U.S. Direct Investment Abroad: Detail for Position and Balance of Payments Flows, 1985," *Survey of Current Business*, August 1986, pp. 40-73.

³Published by the Department of the Treasury.

⁴The DOC is able to provide a detailed comparison of these two sources.

⁵The World Bank in its *World Debt Tables* publishes the total external debt of countries. The amount of that debt owed to the United States is not presented, and thus that source was not helpful in this report's calculations.

Table 1

DEPARTMENT OF COMMERCE'S INTERNATIONAL INVESTMENT
POSITION OF THE UNITED STATES, 1985 AND 1986
(In millions of U.S. dollars, year end)

Line	Type of investment	Changes in position in 1986 (decrease in +)					Position by area											
		Position 1985	Capital flows (a)	Price changes (b)	Ex. change (c)	Other changes (d)	Total (a+b+c+d)	Position 1986	Western Europe	Canada	Japan	Latin American Republics and other Western Hemisphere	Other countries, international organizations, and unallocated					
1	Net international investment position of the United States (line 2 less line 20)	111,882	117,404	28,139	8,865	15,004	151,682	263,564	201,541	290,075	53,165	48,759	46,073	64,653	54,721	25,269	27,444	7,134
2	U.S. assets abroad	949,371	95,982	8,704	11,768	2,063	118,517	1,067,888	316,148	363,916	119,365	32,177	56,744	91,846	264,932	283,148	192,179	196,799
3	U.S. official reserve assets	43,185	312		5,670	26	5,381	48,516	8,491	11,273	(*)	(*)	4,365	5,857		198	30,380	31,189
4	Gold	11,090					26	11,064									1,586	1,586
5	Special drawing rights	7,293	246		855		1,102	8,395									7,293	8,395
6	Reserve position in the International Monetary Fund	11,947	1,501		1,294		-217	11,730									11,947	11,730
7	Foreign currencies	12,856	942		3,531		4,472	17,328	8,491	11,273	(*)	(*)	4,365	5,857		198		
8	U.S. Government assets, other than official reserve assets	87,657	1,920		124	5	1,791	89,448	10,321	9,966	618	546	453	352	16,517	17,276	59,746	61,307
9	U.S. loans and other long-term assets *	85,810	2,840		53	3	2,794	88,594	10,184	9,833	589	528	410	322	16,232	17,065	58,395	60,846
10	Repayable in dollars	84,083	2,900		3	16	2,913	86,996	9,963	9,644	589	528	410	322	15,841	16,677	57,280	59,825
11	Other *	1,727	60		50	19	129	1,596	221	189				381	388		1,115	1,021
12	U.S. foreign currency holdings and U.S. short-term assets	1,847	920		71	2	993	854	137	133	29	18	43	30	285	211	1,351	461
13	U.S. private assets	918,527	94,374	8,704	6,222	2,065	111,395	929,922	297,396	342,677	118,747	31,631	51,926	85,637	248,415	265,674	102,103	104,303
14	Direct investment abroad	225,744	28,047		3,082		29,890	254,831	105,371	123,183	47,106	50,178	9,246	11,333	27,901	34,370	40,124	40,228
15	Foreign securities	112,833	3,302		8,704	6,222	18,338	134,477	58,474	67,644	23,551	2,908	5,466	4,151	2,553	1,908	5,684	5,684
16	Bonds	72,994	2,561		2,274	2,328	7,163	80,137	29,869	37,684	33,296	34,886	6,161	4,718	1,583	1,908	6,666	6,666
17	Corporate stocks	39,839	741		6,430	3,894	11,065	50,904	20,495	28,714	13,529	15,902	3,941	4,718	683	928	3,191	3,191
18	U.S. claims on unaffiliated foreigners reported by U.S. nonbanking concerns	28,583	3,986				3,986	32,569	10,553	11,424	4,430	5,151	1,491	1,875	9,594	11,081	3,015	3,038
19	U.S. claims reported by U.S. banks, not included elsewhere	447,363	59,039				59,039	506,402	131,448	141,692	20,396	25,514	35,633	67,711	208,679	216,715	51,107	54,770

Table 1--continued

20	Foreign assets in the United States	1,061,233	213,366	36,413	2,903	17,067	270,199	1,331,452	517,649	643,991	66,200	83,418	102,817	156,499	10,211	127,479	164,335	189,665
21	Foreign official assets in the United States	202,502	34,696	3,697			38,295	240,797	78,184	92,670	1,475	2,262	(*)	(*)	11,813	8,984	(*)	(*)
22	U.S. Treasury securities	143,440	33,301	693			33,994	177,434	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
23	U.S. Government securities	135,740	34,515	493			35,007	170,747	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
24	Other U.S. Government securities	7,700	1,214	200			1,723	1,687	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
25	Other U.S. Government securities reported by U.S. banks, not included elsewhere	15,647	1,723				1,723	1,687	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
26	U.S. liabilities reported by U.S. banks, not included elsewhere	26,734	554				554	27,288	3,313	4,784	158	255	1,444	1,513	775	728	9,957	10,792
27	Other foreign official assets	16,681	880	2,904			2,024	18,705	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
28	Direct investment in the United States	854,751	174,869	33,246	2,903	17,067	231,904	1,090,655	439,505	553,323	64,725	81,156	(*)	(*)	(*)	(*)	(*)	(*)
29	U.S. Treasury securities	143,440	33,301	693			33,994	177,434	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
30	U.S. Government securities	135,740	34,515	493			35,007	170,747	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
31	Other U.S. Government securities	7,700	1,214	200			1,723	1,687	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
32	U.S. securities other than U.S. Treasury securities and other bonds	206,628	70,802	23,201	2,903	17,067	12,320	9,556	121,413	141,323	17,113	15,312	19,313	23,433	16,326	14,194	9,932	11,721
33	Corporate securities	82,495	33,779	2,917	2,903		92,906	309,334	150,621	217,962	25,244	31,364	10,503	25,340	12,220	16,437	8,140	16,429
34	U.S. liabilities to unaffiliated foreigners reported by U.S. nonbanking concerns	124,133	17,029	26,284			39,509	142,094	68,113	111,865	1,575	2,168	8,613	19,711	1,812	3,345	2,982	5,004
35	U.S. liabilities reported by U.S. banks, not included elsewhere	29,375	2,791				43,307	16,857	82,408	106,098	23,659	29,196	1,890	5,621	10,408	15,092	5,758	11,253
		354,497	77,350			17,333	94,682	449,179	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)

* Revised

† Preliminary
‡ Includes U.S. gold stock
Less than \$500,000 (±)

1. Represents gains or losses on foreign currency-denominated assets due to their revaluation at current exchange rates.
2. Includes changes in coverage, statistical discrepancies, and other adjustments to the value of assets.

3. Reflects U.S. Treasury sales of gold medallions and commemorative and bullion coins; these denormalizations are not included in international transactions capital flows.
4. Also includes paid-in capital subscriptions to international financial institutions and outstanding amounts of miscellaneous claims that have been settled through international agreements to be payable to the U.S. Government over periods in excess of 1 year. Excludes World War I debts that are not being serviced.

5. Includes indebtedness that the borrower may contractually, or at its option, repay with its currency, with a third country's currency, or by delivery of materials or transfer of services.
6. Includes, as part of international und unallocated, the estimated direct investment in shipping companies operating under the flag of Honduras, Panama, and Liberia, and in U.S.-affiliated multinational trading, finance and insurance companies.
7. U.S. holdings of Japanese securities may be understated. This is in part due to the recording of securities transactions by country of transaction rather than by country of issuer.
8. Details not shown separately are included in totals in lines 21 and 28.
9. Details not shown separately are included in line 20.
10. Primarily includes U.S. Government liabilities associated with military sales contracts and other transactions arranged with or through foreign official agencies.

SOURCE: Russell B. Scholl, "The International Investment Position of the United States in 1986," Survey of Current Business, June 1987, Table 1, p. 39.

Bulletin.⁶ The Federal Reserve Board publishes the *Flow of Funds Accounts*, which presents the U.S. asset and liabilities position, as well as international transactions statistics. The *Flow of Funds Accounts* presentation is based in part on BEA data. However, it also draws upon other sources, including bank call reports and nongovernmental sources.⁷ The *Flow of Funds Accounts* and the DOC international investment position differ in their perspectives and in the definition of some components. The DOC is a net asset position from the point of view of the United States. The *Flow of Funds Accounts* presents a foreign sector consisting of foreign assets in the United States and foreign liabilities to the United States. Additional differences involve the incorporation of the data on banking and gold. For example, the DOC classifies International Banking Facilities (IBFs) as U.S. banks. This is a location-based approach. The Federal Reserve System (which otherwise follows a location-based approach) counts IBFs as foreign banks, although their offices may be located in the United States. Furthermore, gold is treated differently; this is explained below under "The Gold Adjustment." Thus, the *Flow of Funds Accounts* presentation of end-of-period assets and liabilities produces net positions over time that differ from the DOC compilation of net assets.

The Federal Reserve Board also produces a detailed breakdown of financial flows, claims, and liabilities. An introduction to international and U.S. statistics on foreign lending by banks is given in the October 1986 issue of the *Federal Reserve Bulletin*.⁸ Although some specific tables in the *Federal Reserve Bulletin* are similar to tables in the *Treasury Bulletin*,⁹ others differ.¹⁰ And although DOC and Federal Reserve Board items differ, the two data sets are reconcilable.¹¹

This report adheres to the framework presented by the DOC and adopts the data sources that the popular press uses to discuss the "debtor" position of the United States. Thus, *Survey of Current Business* data were primarily used, and *Treasury Bulletin* capital flows data were consulted for further detail. The Federal Reserve Board's *Flow of Funds Accounts* was not followed.

⁶Published by the Federal Reserve System.

⁷See an unpublished manuscript by Guido E. Van der Ven and John F. Wilson, "The United States' International Asset and Liability Position: A Comparison of Flow of Funds and Commerce Department Presentations," Board of Governors of the Federal Reserve System International Finance Discussion Papers, No. 295, November 1986.

⁸See Rodney H. Mills, "Foreign Lending by Banks: A Guide to International and U.S. Statistics," *Federal Reserve Bulletin*, October 1986, pp. 683-694.

⁹See, for example, *Federal Reserve Bulletin*, May 1987, Table 3.23, p. A64, where the revised totals are the same as those in the *Treasury Bulletin*, March 1987, Table CM-IV-4, p. 100.

¹⁰For example, *Federal Reserve Bulletin*, May 1987, Table 3.21, p. A62.

¹¹For a detailed comparison, see Van der Ven and Wilson, "The United States' International Asset and Liability Position."

III. ADJUSTMENTS OF THE DATA

THE DIRECT INVESTMENT ADJUSTMENT

This report remains within the framework set forth by the DOC, as explained in the previous section. Thus, in adjusting the data, we will respond to the more common criticisms of the data presented in the DOC international investment position.

Although the DOC updates the values of stocks and bonds,¹ it does not update the value of direct investment. Thus, one of the most common criticisms of the DOC data is that direct investment is recorded at book value. An alternative way to state this is that direct investment is recorded at historic original cost.² The value of the direct investment is not updated. Because much U.S. direct investment abroad is older than foreign direct investment in the United States, the criticism of this data is valid. The book value of older investments diverges from the market value of those investments to a greater degree than the book value of newer investments diverges from their market value. Thus, we attempt to update the value of both U.S. direct investment abroad and foreign direct investment in the United States.

Over time two forces act on the value of capital. First, inflation raises its value in resale or replacement terms. Second, depreciation reduces its value. As a first approximation, direct investment, which represents actual physical capital and real estate, was simply inflated to the year in question through the U.S. implicit GNP deflator. The adjustment may appear one-sided to the extent that the direct investment flows are inflated but not depreciated. However, this is not the case. Due to firms' accounting techniques, capital flows that consist of equity capital, reinvested earnings, and intercompany debt flows³ have already been reduced by depreciation allowances of the firms. Thus, further depreciation of these flows is inappropriate. The calculations are described in detail below.

¹The components of the adjustment are presented annually in the DOC June issue of *Survey of Current Business*. They consist of an adjustment due to price changes in the bonds or stocks, changes in the values of assets/liabilities denominated in foreign currencies due to changes in exchange rates, capital flows and changes due to statistical discrepancies, and changes in coverage and "other" adjustments of the values of assets/liabilities.

²This problem is mentioned in Louis Uchitelle, "Economic Scene: America's Role as a Net Debtor," *The New York Times*, July 1, 1987, p. D2.

³See, for example, *Survey of Current Business*, June 1987, Table 5, p. 71.

The method of calculation was identical for U.S. direct investment abroad and foreign direct investment in the United States. The calculation used DOC numbers, which are reported in U.S. dollars. Thus, no adjustment was made for exchange rate fluctuations. The capital flows for the years 1946 to the year in question (the calculation was carried out for the years 1983 through 1986) were inflated and then summed. To inflate each flow, the U.S. GNP implicit price deflator was used as published in the *Economic Report of the President*.⁴ The new sum of flows was then added to the 1945 direct investment level, also denominated in dollars of the year in question. As mentioned above, the data were not depreciated. Firms fully expense out capital costs over time through depreciation allowances. This accounting affects reinvested earnings of the firms, which are a component of the direct investment capital flow. In addition, depreciation charges are included in intercompany debt positions. Therefore, it is not appropriate to depreciate the flow data (again) to arrive at a reasonable estimate of market valuation of these direct investments.

The calculation had a substantial impact on the direct investment component of the international investment position. The magnitude of the upward adjustment ranged from \$276.7 billion to \$324.8 billion for U.S. direct investment abroad. The 1986 figure experienced the largest adjustment; the value of U.S. direct investment abroad in that year changed from a total of \$260 billion to \$585 billion. For foreign direct investment in the United States, the range of adjustment was from \$46.2 billion to \$64.8 billion. For 1986, total foreign direct investment in the United States changed from \$209.3 billion to \$274.2 billion. The results of this adjustment can be seen in Table 2.

The magnitudes of the adjustments were as expected. As mentioned earlier, the motivation behind this calculation came from the fact that much U.S. direct investment abroad occurred many years ago, while much foreign direct investment in the United States is recent. The older U.S. direct investment abroad experienced a larger adjustment in value than did the more recent foreign direct investment in the United States.

THE GOLD ADJUSTMENT

Another common criticism of the DOC data is that the U.S. Official Reserve gold holdings are valued at the official price of gold.⁵ The

⁴*Economic Report of the President*, 1987, p. 248.

⁵For a discussion of the calculation limitations of the net international investment position, see Robert A. Johnson, "U.S. International Transactions in 1985," *Federal Reserve Bulletin*, May 1986, p. 287.

Table 2

DIRECT INVESTMENT ADJUSTMENT RESULTS, 1983-1986
(In millions of U.S. dollars, year end, making
no adjustment for depreciation)

Investment Category	1983	1984	1985	1986
<i>U.S. Direct Investment Abroad</i>				
1. Department of Commerce	207203.00	212994.00	229748.00	259890.00
2. Adjusted value	483926.10	506414.56	540064.69	584737.58
3. Magnitude of adjustment (line 2 - line 1)	276723.10	293420.56	310316.69	324847.58
<i>Foreign Direct Investment in the United States</i>				
4. Department of Commerce	137061.00	164583.00	184615.00	209329.00
5. Adjusted value	183269.25	215683.85	242911.98	274161.73
6. Magnitude of adjustment (line 5 - line 4)	46208.25	51100.85	58296.98	64832.73
<i>Net Direct Investment</i>				
7. Department of Commerce (line 1 - line 4)	70142.00	48411.00	45133.00	50561.00
8. Adjusted (line 2 - line 5)	300656.85	290730.71	297152.71	310575.85

SOURCES: The 1983 and 1984 DOC direct investment levels were taken from Russell B. Scholl, "The U.S. International Investment Position in 1985," *Survey of Current Business*, June 1986, Table 2, p. 28. The 1985 and 1986 direct investment levels were obtained from Russell B. Scholl, "U.S. Net International Investment Position, 1986," *Department of Commerce News*, June 23, 1987. The 1985 numbers are revised, while the 1986 numbers are preliminary. The numbers were drawn from various issues of the *Survey of Current Business* and adjusted as explained.

official price of gold is \$42.22 per fine troy ounce.⁶ The market price of gold is considerably higher—for the years in question, it was approximately \$380 per fine troy ounce. Thus, this study adjusts the value of the gold stock.

The calculation involved dividing the DOC number (line 4 in Table 1 above) by the official price of gold to find the holdings in ounces. The number of ounces was multiplied by the London fixing p.m. price

⁶*Survey of Current Business*, June 1986, Table 2, footnote 1, p. 28. Specifically, the price of gold is \$42.2/9.

of gold⁷ quoted for the last market day of the year in question. The magnitude of the adjustment ranged from \$69.9 billion to \$90.8 billion, as expected. It can be attributed to the large divergence between the market and official prices of gold. The results of the calculation are presented in Table 3.

THE CLAIMS ADJUSTMENT

Finally, the 1982 debt crisis indicates that many U.S. claims on foreigners are not worth their book value. Specifically, the existence of secondary debt markets suggests that the value of the debts owed by many less developed countries (LDCs) is lower than the book value, or recorded debt value. Thus, we recalculated the DOC estimate of U.S. claims on unaffiliated foreigners, as reported by U.S. nonbanking concerns, and U.S. claims reported by U.S. banks⁸ using the secondary debt market valuations.

Table 3

GOLD ADJUSTMENT RESULTS, 1983-1986
(In millions of U.S. dollars, year end)

U.S. Official Reserve Gold Holdings	1983	1984	1985	1986
1. Department of Commerce	11121.00	11096.00	11090.00	11064.00
2. Adjusted value	100721.15	81021.24	86598.31	101868.87
3. Magnitude of adjustment (line 2 - line 1)	89600.15	69925.24	75508.31	90804.87

SOURCES: The 1983 and 1984 DOC gold levels were taken from Russell B. Scholl, "The U.S. International Investment Position in 1985," *Survey of Current Business*, June 1986, Table 2, p. 28. The 1985 and 1986 gold levels were obtained from Russell B. Scholl, "U.S. Net International Investment Position, 1986," *Department of Commerce News*, June 23, 1987. The 1985 numbers are revised, while the 1986 numbers are preliminary.

⁷London fixing post meridiem price of gold is the price of gold quoted in London, based on the closing price of gold in New York City. It appears to be based on the Handy and Harmon base price. It can be found daily in the *Wall Street Journal* under "Cash Prices" in the Precious Metals section.

⁸Lines 18 and 19 of Table 1.

The most commonly cited method for unloading LDC debt is through a debt-equity swap. This process involves two independent stages: (1) sale of the claim on the LDC in the secondary debt market, and (2) conversion of the claim into equity in the LDC.⁹ It is the first stage that has bearing on this analysis. Bank claims on LDCs should be assessed at less than face value because they will not fetch face value in the secondary debt market (regardless of what happens to the claims beyond that). Thus, because a U.S. bank claim on a less developed country can be traded in this manner, the claims should be marked to market when considering the international investment position.

Because of the "thinness" of the secondary debt market, the calculation was done for 13 countries: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Nigeria, Philippines, Poland, Peru, Uruguay, and Venezuela. Furthermore, ranges of foreign debt prices can be found. The ranges are presented in Table 4. Although the DOC does not publish, for example, the total debt of Mexico to the United States, Mexican debt is included in the international investment position of the United States. It appears primarily in "U.S. loans and other long-term assets" (line 9), "U.S. claims on unaffiliated foreigners reported by U.S. nonbanking concerns" (line 18), and "U.S. claims reported by U.S. banks, not included elsewhere" (line 19).¹⁰ However, foreign countries' total liabilities to U.S. banks and nonbanks can be found in the *Treasury Bulletin* Capital Movements section and in the IMF's *International Financial Statistics*. Using the *Treasury Bulletin* breakdown (by country) of bank and nonbank claims,¹¹ this analysis multiplied the claims by an average of secondary debt market prices (presented in Table 4). Seeking a "middle of the road" estimate

⁹A brief explanation of secondary debt swaps is as follows: The secondary debt market may involve the swapping of LDCs' debts for equity. This swap involves the purchase of a foreign debt instrument at the market discount rate. Generally, a bank sells its loans at the discount rate to a company wanting to invest in the debtor country. The debt note is then redeemed at the debtor country's central bank or other designated government authority for its original value in the local currency. The local currency is invested in a local company. The conversion from debt into an equity claim on the debtor country is then complete. See Brian Hannon and Scott Gould, "Debt/Equity Swaps Help Latin America out of Its Debt Dilemma," *Business America*, January 19, 1987, pp. 3-4. They also discuss the programs of Chile, Mexico, and Brazil and list some foreign debt prices. See also Eric N. Berg, "Markets Fail to Develop for Third-World Debt," *The New York Times*, June 1, 1987, Business Day, pp. Y21-Y23.

¹⁰See Table 1 above.

¹¹See, for example, the Capital Movements section of the March issues of *Treasury Bulletin* for the year-end numbers of the previous year. Specifically, Tables CM-II provide information on bank claims, while Tables CM-IV provide information on nonbank claims. These numbers are also identical to the numbers reported in the IMF's *International Financial Statistics*, line 9b.d.

Table 4
FOREIGN DEBT PRICES FROM THE EARLY 1980S
(In cents per U.S. dollar)

Country	Foreign Debt Prices	Average
Argentina	60-67	63.5
Bolivia	10-12	11
Brazil	55-78	66.5
Chile	66-70	68
Colombia	87-87	87
Ecuador	62-62	62
Mexico	58-69	63.5
Nigeria	37-60	48.5
Philippines	71-73	72
Poland	50-53	51.5
Peru	11-28	19.5
Uruguay	72-75	73.5
Venezuela	74-81	77.5

SOURCES: Many sources were consulted to find foreign debt prices: Hannon and Gould, "Debt/Equity Swaps"; Charles W. Pluckham, "Legislators Look to Secondary Debt Market to Lighten Banks' Debt Load," *Investor's Daily*, May 22, 1987, p. 33; Jeffrey D. Sachs, "Should Some Latin Debt Be Forgiven? It's the Right Time to Offer 'Real Relief,'" *The New York Times*, August 9, 1987, Business Day; S. Karene Witcher and Richard B. Schmitt, "Growing Market in Third World Debt Raises Questions on the Loans' Value," *The Wall Street Journal*, October 7, 1986, p. 21.

NOTE: The average is found by adding the low and high numbers in the range and then dividing that sum by two.

of debt value, the study used a simple average of the lowest and highest debt prices. Marking to market (for lines 18 and 19) served to reduce the value of U.S. claims on foreigners. The magnitude of the adjustment ranged from negative \$37.5 billion to negative \$39.6 billion. The results are reported in Table 5.

Table 5
CLAIMS ADJUSTMENT RESULTS, 1983-1986
(In millions of U.S. dollars, year end)

Claims Item	1983	1984	1985	1986
<i>DOC Statistics</i>				
1. U.S. bank claims	434505.00	445631.00	447363.00	506402.00
2. U.S. nonbank claims	35077.00	20996.00	28583.00	32569.00
3. Total	469582.00	475627.00	475946.00	538971.00
<i>Adjusted Statistics</i>				
4. U.S. bank and nonbank claims (in 1986 dollars)	429937.67	436071.88	437969.26	501462.60
5. Magnitude of adjustment (line 4 - line 3)	-39644.33	-39555.12	-37976.74	-37508.41

SOURCES: The 1983 and 1984 DOC claims levels were taken from Russell B. Scholl, "The U.S. International Investment Position in 1985," *Survey of Current Business*, June 1986, Table 2, p. 28. The 1985 and 1986 claims levels were obtained from Russell B. Scholl, "U.S. Net International Investment Position, 1986," *Department of Commerce News*, June 23, 1987. The 1985 numbers are revised, while the 1986 numbers are preliminary. The adjusted claims were drawn from various issues of the *Treasury Bulletin* and the IMF's *International Financial Statistics* and adjusted as explained. The average of the foreign debt price listed in Table 4 above was used in the calculation.

IV. DEFINITION OF DEBTOR

Section III discussed the adjustments to various components of Table 1. Those adjustments affected the data alone. However, it is important to consider not only the data but also the framework of presentation. This section shows the impact of those calculations on the U.S. international investment position as presented by the DOC—its presentation is the one that has been adopted by the popular press as the U.S. “debtor position.” Then the usefulness of this definition of “debtor” will be considered.

Still using the DOC categories, it is possible to refine the term “debtor position.” A possible distinction is along the lines of servicing burdens of the assets or liabilities. Stocks and direct foreign investment differ from bonds and financial institutions’ credits and debits in that the former pay or yield a variable and uncertain return while the latter face predetermined servicing burdens or returns. Thus, the full balance sheet presented by the DOC can be broken down into two subsheets: nondebt and financial balances. Furthermore, U.S. Official Reserve gold holdings (line 4 of Table 1) are included in the DOC international investment position. However, gold does not represent a claim on anyone in particular and perhaps should not be included. Its inclusion is the result of its previous monetary role. Thus, gold is presented on a separate line in Table 6. Net figures including and excluding gold are also calculated.

The sub-balances are as follows. The nondebt balance includes stocks and direct investment. In Table 1, the U.S. assets included in this balance are “direct investment abroad” (line 14) and “corporate stocks” (line 17); the foreign holdings included have the same titles and are located in lines 29 and 33. These assets/liabilities represent ownership rights and entail variable returns/payments. Gold is then added to this category because it has no servicing burden.¹ The financial net includes all other categories. It is the financial net that is closer to the “debtor” position calculations used for the less developed countries. The full balance sheet is then the nondebt and financial balances combined and is calculated including and excluding gold.

¹Alternatively, it could be argued that gold has a fixed servicing burden of zero and should therefore be added to the financial net. That calculation was not carried out.

This classification does not address the opportunity costs involved in the holding of real assets. Real assets such as gold do have real implicit servicing burdens, which are the opportunity costs of the returns forgone by holding rather than selling the assets.

Table 6

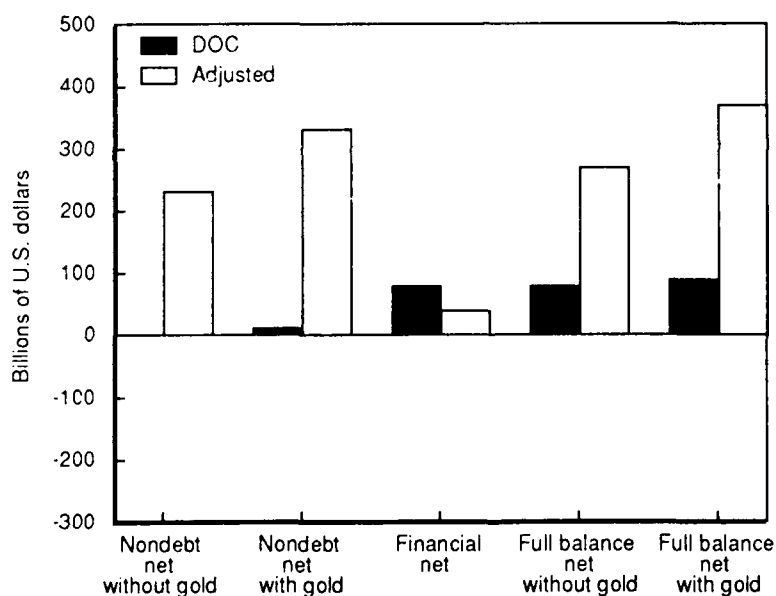
NONDEBT, FINANCIAL, AND FULL BALANCES OF U.S. INTERNATIONAL
INVESTMENT POSITION: ADJUSTED AND DIVIDED
(In billions of U.S. dollars, year end)

Item	1983		1984		1985		1986	
	DOC	Adj.	DOC	Adj.	DOC	Adj.	DOC	Adj.
<i>Nondebt (Direct Investment + Stocks)</i>								
1. U.S. assets abroad	233.7	510.5	240.9	534.3	269.6	579.9	310.8	635.6
2. Foreign assets in the U.S.	234.3	280.5	260.4	311.5	308.7	367.0	376.8	441.6
3. Nondebt net (line 1 - line 2)	-0.6	230.0	-19.5	222.8	-39.2	212.9	-66.0	194.0
4. U.S. Official Reserve gold holdings	11.1	100.7	11.1	81.0	11.1	86.6	11.1	101.9
5. Nondebt net, with gold (line 3 + line 4)	10.6	330.7	-8.4	303.8	-28.1	299.5	-54.9	295.9
<i>Financial</i>								
6. U.S. claims on foreigners	629.2	589.5	646.2	606.6	668.7	630.7	746.0	708.5
7. Foreigners' claims on U.S.	551.2	551.2	633.4	633.4	752.5	752.5	954.7	954.7
8. Financial net (line 6 - line 7)	77.9	38.3	12.8	-26.8	-83.8	-121.8	-208.7	-246.2
<i>Full Balance (Nondebt + Financial)</i>								
9. Full balance net, with gold (line 5 + line 8)	88.5	369.0	4.4	277.1	-111.9	177.7	-263.6	49.8
10. Full balance net, without gold (line 3 + line 8)	77.4	268.2	-6.7	196.1	-123.0	91.1	-274.6	-52.1

SOURCES: The 1983 and 1984 DOC asset levels were taken from Russell B. Scholl, "The U.S. International Investment Position in 1985," *Survey of Current Business*, June 1986, Table 2, p. 28. The 1985 and 1986 asset levels were obtained from Russell B. Scholl, "U.S. Net International Investment Position, 1986," *Department of Commerce News*, June 23, 1987. The 1985 numbers are revised, while the 1986 numbers are preliminary. The adjusted numbers were drawn from various issues of *Survey of Current Business*, the *Treasury Bulletin*, and the IMF's *International Financial Statistics*. They were adjusted as explained.

NOTE: Numbers may not add exactly due to rounding. The calculations were carried out in millions of dollars to the fourth decimal place.

It is now possible to analyze the impact of the adjustments on the various positions. The direct investment adjustment positively affected both the nondebt net and the full balance net. In all four years (1983-1986) the nondebt net without gold moved from negative to positive with this adjustment. The nondebt net with gold also moved from a negative to a positive number in the years 1984-1986. In 1983, it was made a larger positive number. The gold calculation also increases the net investment position. Finally, the claims adjustment negatively affects both the financial net and the full balance net (i.e., reduces the net). In 1983, the financial net is reduced although still positive. In 1984, the positive financial net is made negative. In 1985 and 1986, the already negative financial net is made larger in absolute value by the reduction in the claims values. The combined results are presented in Table 6 above. In addition, Figs. 1 through 4 present the results graphically. When considering the full balance with gold, as the DOC

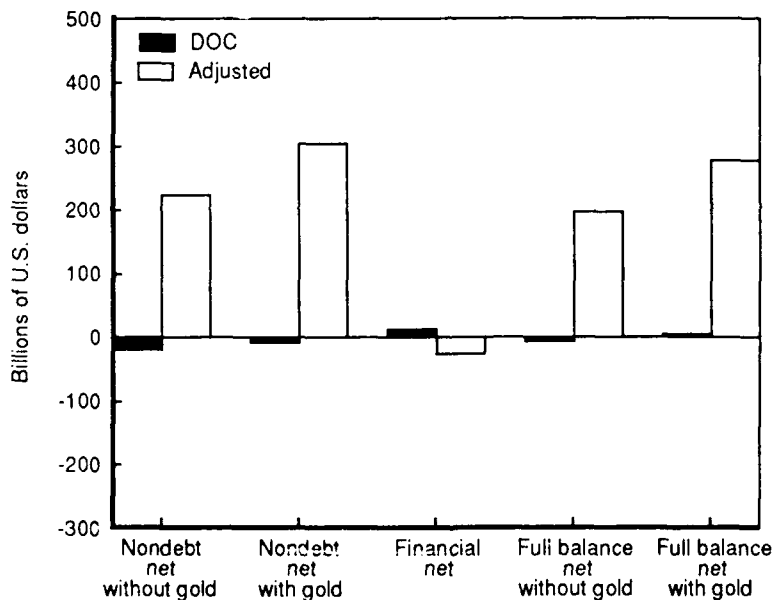


SOURCE: Table 6

Fig. 1—U.S. international investment position,
net results for 1983, year end

does, it is interesting to note that all the adjustments combine to move the United States out of its negative net investment position, not only in 1985 but also in 1986. Alternatively, when the financial net is adopted as the appropriate definition of debtor, the United States is a "debtor" in those two years.²

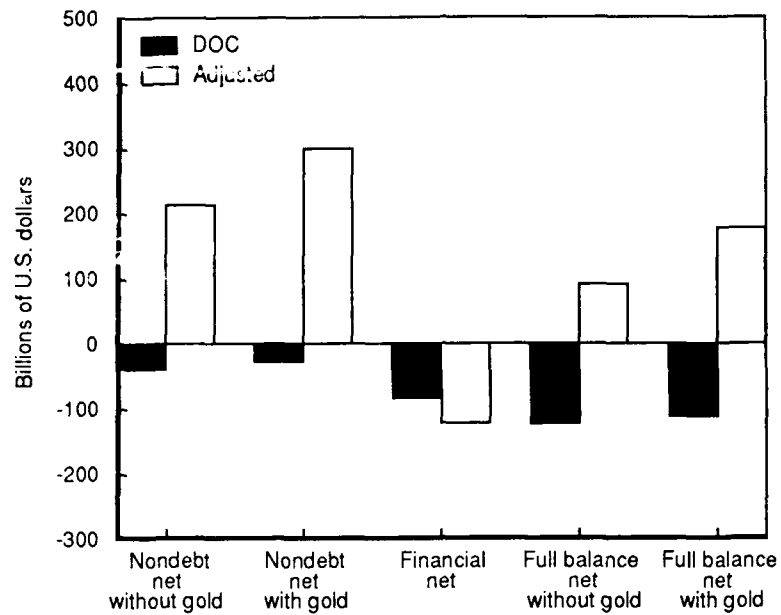
The magnitude of the levels involved in the international investment position is uncertain. The results above indicate that the levels can be changed substantially. Nevertheless, although the full balance "debtor" status disappears, the decline of the net investment position is still evident. Figure 5 clearly shows that the adjustments did not substantially slow the decline of the U.S. international investment position. And, although we find that the United States is not a full balance debtor nation in 1986, it will most likely fall into negative numbers even with



SOURCE: Table 6.

Fig. 2—U.S. international investment position,
net results for 1984, year end

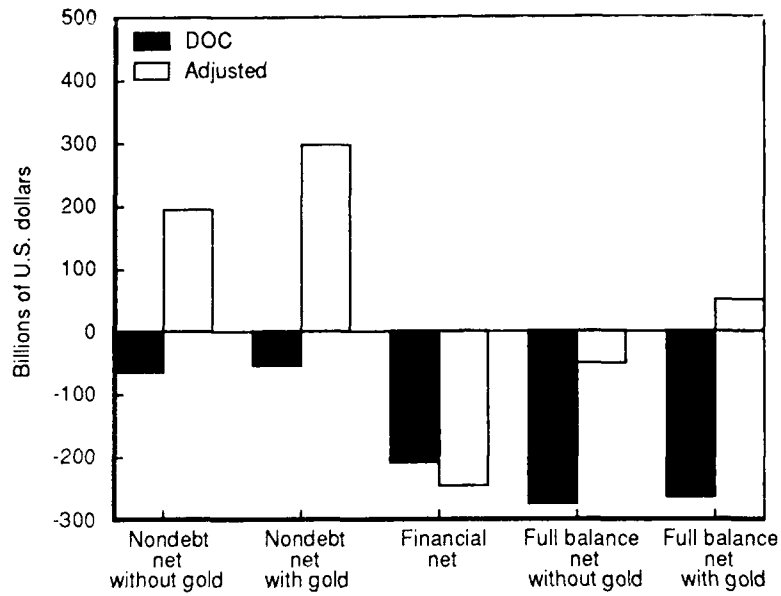
²As will be explained later, the United States became a "debtor" as early as 1971 using this measure.



SOURCE: Table 6.

Fig. 3—U.S. international investment position,
net results for 1985, year end

our adjustments in 1987; however, this prospect may be partially offset by the asymmetrical adjustments (as a result of the October 1987 stock market decline) of U.S. and foreign holdings of equities.



SOURCE: Table 6.

Fig. 4—U.S. international investment position,
net results for 1986, year end

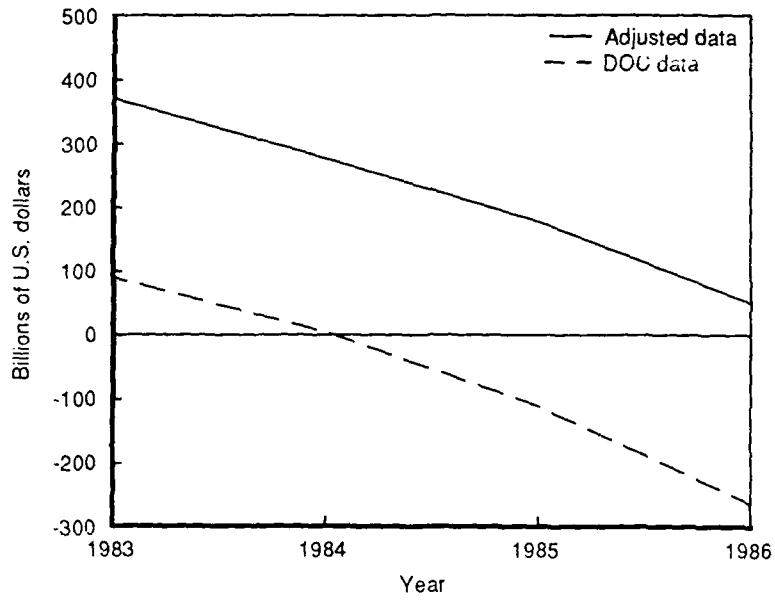


Fig. 5—U.S. international investment position, summary of net results for 1983–1986, gold included, year end

V. LIMITATIONS AND EXTENSIONS

The limitations of this report, and indeed of the international investment position computations in general, can be divided into three types: (1) problems with the data, (2) limitations on the adjustments presented, and (3) problems associated with the format of the presentation of the U.S. international asset and liability position.

DATA

The data can be considered as the first of three dimensions of "debtor." Discrepancies in the data collection are evidenced in part by the reporting of a statistical discrepancy in the balance of payments accounting. These net unrecorded flows could be attributed to capital or trade flows or to a combination of both. For example, the Department of Commerce admits that the 1986 merchandise deficit with Canada was not \$21 billion as it had reported, but closer to \$11 billion.¹ It is possible to argue that the statistical discrepancy represents a combination of miscalculations of exports and imports as opposed to a miscalculation of capital flows. Thus, in Sec. III the international investment position was not adjusted to account for the statistical discrepancy. On the other hand, it can be argued that this correction and revision of the trade figures make the current account figures more reliable and thus suggest that the statistical discrepancy represents unrecorded capital flows.² Thus, the other extreme position is that the entire statistical discrepancy represents unrecorded capital flows.³

Another problem with the data is related to the reports of affiliates transactions. Intercompany transactions often occur at internal transfer prices or transactions prices. These internal prices may not be equal to either market or book value. Thus, ambiguities result from the internal accounting methods of the firms. Further, the direction of adjustment is uncertain.

¹The Wall Street Journal, "Hiding a Boom in a Statistical Bust," August 6, 1987, p. 22.

²See, for example, Jack Baume, "A Note on the U.S. as a Debtor Nation," *Survey of Current Business*, June 1985, p. 28; or Peter Isard and Lois Stekler, "U.S. International Capital Flows and the Dollar," *Brookings Papers on Economic Activity*, 1, 1985, pp. 219-225; or Russell B. Scholl, "The International Investment Position of the United States in 1986," *Survey of Current Business*, June 1987, p. 38.

³A positive statistical discrepancy indicates unrecorded capital inflow. The statistical discrepancy became persistently large and positive beginning in 1978. Between 1960 and 1975 it was almost always negative, being positive only in the years 1966, 1968, and 1975.

In addition, Isard and Stekler enumerate and adjust for two further limitations on the data.⁴ First, they note that borrowing abroad by U.S. companies by issuing Eurobonds through their Netherlands Antilles financial affiliates is recorded as a reduction in U.S. direct investment claims on foreigners, rather than as an increase in the claims of foreigners on the United States. Although a reduction in claims has the same impact on the net position as an increase in liabilities, the distinction is important when investigating the causes behind changes in the net position or analyzing the composition of the net position.⁵ Second, they mention the problem of ambiguity in interbank transactions.

There is also the problem of "off-balance sheet" transactions. Off-balance sheet activities include commitments, guarantees, trading positions, and other bank products that expose banks to risk but do not appear in their balance sheets.⁶ They may have an impact on the performance and assets and liabilities of financial institutions. Furthermore, the creativity of the banking industry has led to the creation of short-term note issuance facilities, which also carry out off-balance sheet activities.⁷

Although the corporate stocks in the international investment position are maintained at market value, there are shortcomings in the adjustment to market value. Specifically, these shortcomings are the result of insufficient information and volatility of the data. In updating the stocks, the mix of foreign-held stocks in the United States is compared with the *Standard & Poor's* 500. The mix of U.S. stocks held abroad is valued using share price indices for major countries (as published by the IMF).⁸ The DOC adjustments on the values of U.S. stocks abroad are less precise than their adjustments on the foreign-held stocks in the United States. This is due to information deficiencies.⁹ Second, fluctuations in the value range of stocks in the stock market can lead to changes in their recorded values, which affect the international investment position. Recently, part of the decline of the international investment position has been the result of large increases

⁴Isard and Stekler, "U.S. International Capital Flows," p. 221.

⁵In the *Flow of Funds Accounts*, borrowing abroad by U.S. companies through their Netherlands Antilles affiliates is not included in direct investment but is counted in foreign holdings of U.S. bonds.

⁶*The Economist*, "International Banking," March 21, 1987, p. 39.

⁷See *The Economist*, "International Banking," and Robert N. McCauley, "Are Large U.S. Banks Moving International Activity Off Their Balance Sheets?" Federal Reserve Bank of New York, *Quarterly Review*, Summer 1986, pp. 42-44. Any adjustment for contingent off-balance sheet activities should avoid double accounting. For example, in the case of a loan guarantee, if the contingency is realized, a transfer of liability may occur intranationally although liabilities internationally remain unchanged.

⁸Telephone conversation with Russell B. Scholl.

⁹*Ibid.*

in the values of stocks held by foreigners in the United States. Thus, changes in stock values can have an impact on the position.

ADJUSTMENTS

The adjustments have the potential to affect two dimensions of "debtor": data, and composition of components. This study's adjustments deal with the former; the extensions address both dimensions. There are also limitations on the three adjustments calculated in Sec. III above. First, all three adjustments are approximate in nature. Second, if the items marked to market were actually sold off, the impact of their sale on the market would have to be considered. For example, if the government were to unload gold reserves, the price of gold would be affected.¹⁰ Furthermore, the foreign debt prices used in the claims adjustment originate from a very thin market. Only a small percent of LDC debt has actually been sold; the impact of widespread debt sale is not addressed. The limitations and extensions of the three adjustments will be discussed in turn.

In the direct investment adjustment, a general implicit price deflator is used. Perhaps it would be interesting to do the adjustment with a more investment-specific implicit price deflator, such as the gross private domestic investment implicit price deflator.¹¹ Furthermore, the adjustment is approximate because it does not deal with some important issues, such as exchange rate fluctuations. It is also important to consider the location and types of the investments or stocks. Location is of consequence if country-specific inflation rates and exchange rates are to be addressed. Finally, industry-specific adjustments could be made if the exact composition by industry of the investment figures was found. For example, real estate values have tended to increase quite rapidly, but the value of assets in the oil industry has fallen. Furthermore, assets seized in politically troubled countries such as Iran may still be on the books.

As mentioned in the discussion of data ambiguities above, it is often suggested that the positive statistical discrepancy in the balance of payments accounts represents an inflow of capital. Thus, it is suggested that the discrepancy should be considered as an increase in foreign investment in the United States.

Adjustment of the data can be made assuming that the statistical discrepancy is entirely due to unrecorded capital flows. First, the

¹⁰The magnitude and timing of the impact would depend on whether it is known in advance that the gold sale is going to occur.

¹¹This can also be found in the *Economic Report of the President*, 1987, p. 248.

cumulative statistical discrepancy from 1960 to the year in question (1983-1986) is calculated. Second, the cumulative statistical discrepancy is subtracted from the DOC full balance net. Finally, it is subtracted from our adjusted full balance net. Two additional nets result and are shown in Table 7. Adjustment of the DOC net in this manner leads to "debtor" status as early as 1983.¹² Adjustment of our full balance net in this manner leads to a negative net in 1986.

Rather than one of these two extremes, the statistical discrepancy probably represents a combination of miscalculation of current and capital accounts. Thus, the appropriate adjustment lies somewhere in between.

Table 7

U.S. INTERNATIONAL INVESTMENT POSITION, 1983-1986
(In millions of U.S. dollars, year end)

Item	1983	1984	1985	1986
<i>DOC Statistics, Adjusting for Statistical Discrepancy</i>				
1. Full balance net	88494	4384	-111882	-263564
2. Cumulative statistical discrepancy	123604	150942	168862	192809
3. Line 1 - line 2	-35110	-146558	-280744	-456373
<i>Section IV Statistics, Adjusting for Statistical Discrepancy</i>				
4. Full balance net, with gold	368965	277074	177669	49747
5. Cumulative statistical discrepancy	123604	150942	168862	192809
6. Line 4 - line 5	245361	126132	8807	-143062

SOURCES: The statistical discrepancy was added from 1960 to the year in question. The figures for the years 1960 to 1984 were taken from line 65 of "Table 1 - U.S. International Transactions," *Survey of Current Business*, June 1986, pp. 42-43. The figures for 1985 and 1986 were taken from line 65 of "Table 1 - U.S. International Transactions," *Survey of Current Business*, June 1987, p. 55. The 1985 numbers are revised, the 1986 numbers are preliminary. Line 4 uses the adjusted figures from line 9 of Table 6 above.

¹²For 1982, the adjusted net is still positive.

The gold adjustment could be done with different gold prices. Perhaps an average price of gold for the year could be used, as opposed to the market price for the last day of the year. Perhaps no adjustment should be made at all, as these are official reserves and will most likely be retained.

Furthermore, the DOC is asymmetric in its treatment of gold. U.S. gold reserves are counted as assets of the United States. However, foreign gold reserves are not counted as foreign assets. A composition-based correction would involve the addition of foreign gold reserves. This adjustment would move away from the DOC presentation and would adopt a convention followed by the Federal Reserve System in the *Flow of Funds Accounts*.¹³ It would also serve to reduce the net international investment position.

Finally, the claims adjustment is very approximate in nature. While the methodology of the adjustment seems to be correct, it needs to be applied more comprehensively. First, not all claims have been marked to market. Second, only an average of foreign debt prices was used. The foreign debt prices are problematic because they vary across time and transaction. Some of them had large ranges of values. Third, there was no adjustment of line 9 of Table 1, which contains U.S. official loans and other long-term assets. The official nature of this line prevents it from presentation on a country-by-country basis. Nevertheless, the direction of the calculation is apparent.

Looking beyond our adjustments, the definition of the components merits consideration. Thus, the second dimension of the definition of debtor needs to be addressed, particularly the definition of "U.S. banks." DOC and Treasury Department data consider branches of U.S. banks located abroad as foreign banks. Branches' claims on foreigners are not included in their numbers, and claims on foreign branches are counted as claims on foreigners. Also, branches of foreign banks located in the United States are counted as U.S. banks. Thus, their claims on foreigners are counted as part of U.S. claims on foreigners. Basically, this delineation is along the lines of location versus nationality of charter.¹⁴ In considering whether this delineation is appropriate, one should take into account the importance of foreign banks in the U.S. banking system, the degree of their integration into the system, and the rules by which they operate. Wallich suggests that if one wants to find "who owes whom," banks need to be classified by

¹³Van der Ven and Wilson, "U.S. International Asset and Liability Position," p. 5. However, most recent publications of *Flow of Funds Accounts* data have excluded gold altogether.

¹⁴Another possible delineation would be along the lines of ownership.

country of charter.¹⁵ Thus, it might be interesting to use the data from the *Federal Reserve Bulletin*.¹⁶ The banking offices covered are the U.S. offices and foreign branches of U.S.-chartered banks and U.S. subsidiaries of foreign-owned banks. Foreign bank branches located in the United States and foreign subsidiaries of U.S. banks are not included.¹⁷

Similarly, there is a question about the propriety of including in the U.S. balance sheet the transactions of International Banking Facilities that are located in the United States. An alternative calculation of the U.S. debtor position might adopt the *Flow of Funds Accounts* accounting rules for this area.¹⁸

FORMAT

Data limitations affect the first dimension of "debtor," and the adjustments carried out in this report also operate within those limitations. Composition of the components, such as the definition of "U.S. banks," is important and offered as an extension. Finally, selection of components represents the third dimension of "debtor": the format Division of the DOC full balance net international investment into two sub-balances, each of which could independently define "debtor," addresses this third dimension. Comparison over time of the full balance net to the financial net¹⁹ indicates that the format, or selection of elements to be included, has a significant impact on the results obtained.

As mentioned in Sec. I, there are at least two different presentations of the U.S. international exposure or "debt." When looking at the LDCs, one finds even more definitions of debt. Choosing among these accounting methods is not a simple issue. Therefore, it is important to recognize the limitations and potential biases of the approach chosen. We choose the DOC presentation. As mentioned above, it might be interesting to take the approach of the Federal Reserve Board. In addition, to compare the United States with the LDCs, similar delineation

¹⁵Henry Wallich, "Capital Movements—The Tail that Wags the Dog," *The International Monetary System*, proceedings of a conference sponsored by the Federal Reserve Bank of Boston, May 1984, p. 182.

¹⁶*Federal Reserve Bulletin*, International Summary Statistics section, May 1987, Table 3.21, "Claims on Foreign Countries Held by U.S. Offices and Foreign Branches of U.S.-Chartered Banks," p. A62.

¹⁷*Ibid.*

¹⁸Isard and Stekler, "U.S. International Capital Flows," perform an adjustment of this nature.

¹⁹Compare Fig. 5 above to Fig. 6 below.

tions of "debtor" should be used.²⁰ Yet another approach is explored by Kimelman, McKeon, and Sargen, who aim to improve the usefulness and clarity of existing data sources. They try specifically to reduce statistical discrepancy by revising data and making estimates of their own.²¹

This report focuses on the first and third dimensions of debtor. This is not to suggest that the second dimension is trivial. The choice, as well as the composition, of the components is important. Although this study is limited to the DOC categories, it explores *different delineations* of debtor. In the next section, the significance of the delineations will be seen as we compare the United States with the LDCs.

²⁰The problems with this comparison are discussed in detail in Sec. VI.

²¹See the paper by Nancy Kimelman, James McKeon, and Nicholas Sargen, "U.S. Flow of Funds: The International Dimension," Salomon Brothers, Inc., New York, June 1985.

VI. IMPLICATIONS

This section briefly considers two topics: (1) forces behind the decline in the U.S. net international investment position, and (2) concerns over the decline.

Attention has been focused on the negative net international investment position of the United States and on the deficit in the current account. Although our revised numbers show a positive net international investment position for the United States in 1985 and 1986, some policy concerns are still relevant, for three reasons. First, the rate of change of the international investment position has been rapid; our adjusted numbers still show a rapid decline. Second, the net financial position of the United States is negative. Third, the United States will probably become a full balance debtor in 1987 even with our numbers. Because the concerns voiced are related to changes in the asset and liability levels, as well as to the asset and liability levels themselves, policy should be directed toward the trade and capital flows involved. The asset and liabilities will be affected secondarily.

FORCES BEHIND THE DECLINE OF THE U.S. INTERNATIONAL INVESTMENT POSITION

Many forces are behind the decline in the net international investment position of the United States. However, most simply put, the decline is due to the greater growth of foreign assets in the United States (and U.S. liabilities to foreigners) relative to the growth of U.S. assets abroad (and foreigners' liabilities to the United States).

This report will now consider the brief DOC explanations of the main factors responsible for the change in the net international investment position in the years 1983 to 1986. First, the phenomena behind the decline in the position are noted. Then the forces behind the observed phenomena are discussed through a brief analysis of U.S. government policies and economic arguments that attempt to explain the observed flows.

The change in the international investment position is briefly explained annually in the June issue of *Survey of Current Business*. The DOC attributed the 1983 deterioration primarily to three factors: (1) a shift to net capital inflows, mainly by U.S. banks; (2) a stronger expansion by the United States than by other major countries—thus the current account deficit increased sharply; (3) higher interest rates

in the United States, facilitating the capital account adjustment.¹ The combined results lead to a decline in the net international investment position.

The decline in the 1984 net international investment position was attributed to four factors.² First, the performance of the U.S. economy continued to be strong relative to its major trading partners. Second, there were strong credit demands in the United States, some to finance mergers and acquisitions. Third, the United States had relatively high interest rates.³ Finally, the dollar appreciated against major currencies.

Despite the decline in the dollar's exchange value in 1985, demand for U.S. securities remained high.⁴ The United States continued to experience growth greater than or equal to that of its major trading partners, although slower.⁵ Banks continued to increase foreign borrowing, while curtailing lending to foreigners.⁶ The current account deficit grew larger. The end result was a substantial decline in the net international investment position.

The decline in the 1986 position can be primarily explained by three factors. First, low U.S. inflation and rising securities prices attracted foreign capital to the United States.⁷ Thus, large purchases of U.S. corporate stocks and bonds continued. Second, U.S. banks continued to be net borrowers, thus reducing the net position.⁸ And finally, foreign official reserve assets in the United States increased. This occurred as some countries intervened in the exchange markets in order to limit the decline of the dollar against their currencies.⁹

These explanations give a brief history of the net position, but they do not really clarify the motivations or causes behind the capital movements. To evaluate the change in the net international investment position, this study must take a closer look. First, the policy mix of the United States can be analyzed as one of the causes behind the

¹Russell B. Scholl, "The International Investment Position of the United States in 1983," *Survey of Current Business*, June 1984, p. 74.

²Russell B. Scholl, "The International Investment Position of the United States in 1984," *Survey of Current Business*, June 1985, p. 25.

³As will be briefly discussed below, the combination of tight monetary policy, federal government deficit growth, and the 1981 tax law change can explain in part the high U.S. interest rates.

⁴Russell B. Scholl, "The International Investment Position of the United States in 1985," *Survey of Current Business*, June 1986, p. 26.

⁵*Ibid.*

⁶*Ibid.*

⁷Russell B. Scholl, "The International Investment Position of the United States in 1986," *Survey of Current Business*, June 1987, p. 38.

⁸*Ibid.*

⁹*Ibid.*

observed changes. Then the study will consider the economic reasoning behind observed flows.

The changes described above can be explained in part by the U.S. macroeconomic policies of the early 1980s. High returns on U.S. investments can be attributed in part to favorable government policies as opposed to inherently higher profitability. In particular, the 1981 tax law cut taxes and thus increased after-tax returns. Furthermore, tight monetary policy from late 1979 to the early 1980s, designed to combat inflation, put upward pressure on interest rates. In addition, the increased purchase of corporate stocks and direct investment can be attributed in part to the reduction of impediments in U.S. labor markets, which created a more favorable environment for business. Federal borrowing also served to reduce the international investment position as more treasury securities were purchased by foreigners.¹⁰ Given the climate created by the policies, the changes observed can be clarified through economic reasoning.

Consider the increased foreign purchases of equities and direct investment in the United States. This flow indicates the strength of the U.S. economy; economic theory suggests two basic explanations for it. First, there is the safe haven argument—the idea that, compared with the rest of the world, the United States looks like a politically and economically stable country. Thus, for reasons of low political risk, foreigners are investing in dollar-denominated assets in the United States. Second, there is the portfolio analysis approach. This approach recognizes that U.S. assets yield a high rate of return, and thus investors allocate a portion of their portfolios to U.S. assets. The argument is then that the high rate of return attracts foreign investors to U.S. assets. Frankel identifies the differential between real interest rates in the United States and those in other countries as the major cause of the increased attractiveness of U.S. assets in the early 1980s.¹¹ Thus, the portfolio approach finds some empirical support.

Safe haven and portfolio arguments explain the increased purchases of corporate stocks, bonds, and government bonds. Direct investment is also spurred by these considerations. Yet there are other motives for direct investment, for example, the desire to increase market share in the U.S. market and to avoid protectionist measures. In 1986, a surge in German investment was motivated by the former,¹² while increases

¹⁰They can be counted along with increased credit demand as the result of mergers and acquisitions in 1984.

¹¹Jeffrey A. Frankel, "The Dazzling Dollar," *Brookings Papers on Economic Activity*, 1, 1985, p. 199.

¹²Thomas F. O'Boyle, "German Companies Seek More U.S. Assets," *The Wall Street Journal*, October 7, 1986, p. 36.

in Japanese investment can be explained in part by the latter.¹³ So some of the direct investment flows may have been motivated by fears of protectionism.

The discussion above has primarily focused on the causes of capital inflows. There is also the issue of capital outflows, which would serve to improve our international investment position. As explained above, the basic implication of the recent decline in the net investment position can be that the growth of foreign investment in the United States has been larger than the growth of U.S. assets abroad. A possible explanation is a lack of viable investment opportunities abroad.¹⁴ Further, increases in direct investment are explained in part by reinvested earnings. The level of reinvested earnings depends upon the profit level and the availability of profitable investment opportunities. In reference to profit level, profits in the United States have led to increased reinvested earnings, which have served to accelerate foreign investment in the United States. The relative growth of the United States compared with other developed countries may partly explain this.

The financial net position has been falling since 1982. Although the fall is often labeled a deterioration, this is not necessarily the case. Borrowing abroad or domestically brings with it predetermined non-zero servicing payments as well as the obligation to repay the principal. Although the source of funds is unimportant to the borrower, borrowing from abroad is included in the international investment position while domestic borrowing is not. In particular, increased borrowing abroad reduces both the financial net and full balance net. However, it could be argued that U.S. corporations and banks are taking advantage of an integrated banking and financial system. If they opt to borrow internationally, it must be that the best arrangement is an international one. In addition, both the financial net and full balance net are reduced when loans to foreigners are reduced. Again, this should not necessarily be deemed a deterioration. On the claims side, the problems with LDC debts have caused banks to curtail loans to foreigners. The lending frenzy that changed the net financial position from a negative to a positive number in 1981 is over.¹⁵ Thus, claims and flows that served to increase the net international investment position have diminished.

¹³Daniel Yergin, "Worrying About 'Investment Frictions'—When Main St. Belongs to the Japanese," *The New York Times*, July 5, 1987, Business Day.

¹⁴Kimelman, McKeon, Sargen, "U.S. Flow of Funds," p. 7.

¹⁵In addition, banks have sold a small percentage of their LDC loans in secondary debt markets.

CONCERNS

Predominantly, four concerns are voiced in relation to the negative net international investment position of the United States: (1) fear that the United States is becoming like Mexico or Brazil; (2) fear that the U.S. standard of living will fall; (3) increased vulnerability of the U.S. economy and economic variables, such as interest and exchange rates, to the actions of foreign investors; and (4) impact, adverse to the United States, on relations with foreigners. These concerns merit attention even though the revised numbers yield a positive net international investment position.

The headlines have said it again and again: "Largest Debtor" and "Even Bigger Debt than Mexico or Brazil." They voice one of the major concerns: that the United States is becoming like Mexico or Brazil. Upon careful consideration, it is apparent that the comparison is flawed. The net international investment position, as published by the DOC, has caused commotion since 1986, when the negative net international position of 1985 was announced. The popular press has adopted the DOC's net international investment position as the "debtor" position of the United States. However, it would be more appropriate to use the financial net to compare U.S. and LDC debtor positions. While many definitions are used for LDC debt, they are closer to the financial net than to the full balance sheet net. It is interesting to note that when one looks at the U.S. net financial position using the DOC numbers (unadjusted), the United States actually became a "debtor nation" in 1971. Figure 6 shows the DOC financial net from 1970 to 1986. Tables 8 and 9 present the numbers from which Fig. 6 is derived. Although the DOC does not calculate the financial net, this calculation uses unadjusted DOC numbers. Adjustment of these numbers would only reduce the net balance. Thus, concern over debtor status should have started in 1972.

Putting aside the inconsistency of the comparison due to the different definitions of debtor, still other factors should be considered before placing the United States in the ranks of Mexico and Brazil. LDCs, including Mexico and Brazil, face exchange-rate risk to the extent that they borrow in a currency other than the one in which their export earnings are denominated. Most U.S. export earnings and debt are denominated in dollars. Thus, the United States is not exposed to exchange risk and will not encounter the LDC type of debt crisis—one where exports don't generate enough foreign exchange to service and repay the liabilities.

Second, the comparison involves levels of debt. The more important issue is not the level per se, but how large the level of debt is compared

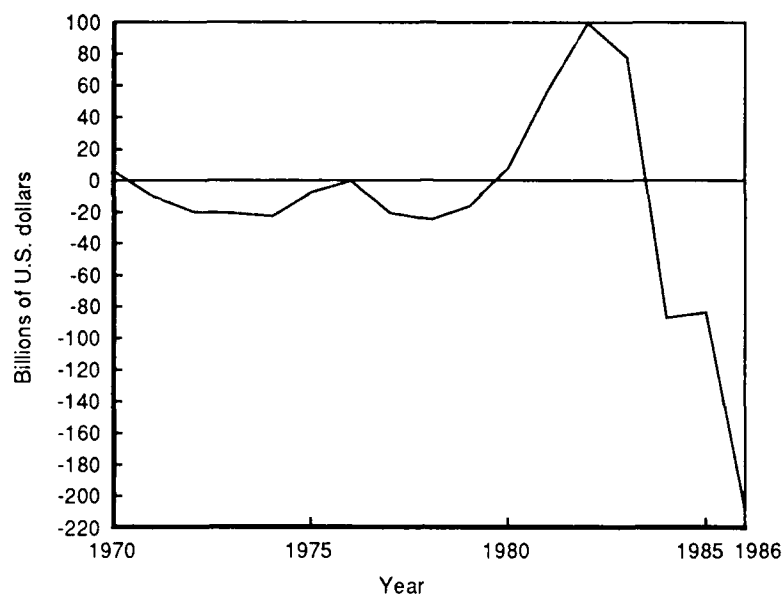


Fig. 6—U.S. net financial position, 1970–1986, year end,
using Department of Commerce data

with the size of the economy. A measure often used to determine this is a calculation of the percent of GNP that the debt level represents.¹⁶ Indices on debt burden, ability to repay debt, and servicing burden are calculated as percentages. Thus, because of the large size of the U.S. economy, the U.S. debt as a percent of GNP is much smaller than the LDCs' debts as a percent of their GNPs. Furthermore, the United States differs from LDCs to the extent that U.S. debts represent assets sufficiently productive to generate a rate of return at least equal to the interest rate on the debts.

This leads to two important differences between U.S. and LDC debtor positions: composition and cause. For example, Mexico and

¹⁶This is a measure used when evaluating the debt positions of the LDCs. Also important are rate of change in the debt position and ability to generate funds for servicing and principal payments.

Table 8

U.S. NET FINANCIAL POSITION, 1970-1977, USING
DEPARTMENT OF COMMERCE DATA
(In millions of U.S. dollars, year end)

Item	1970	1971	1972	1973	1974	1975	1976	1977
1. U.S. assets	165385	179004	198694	222430	255719	295100	347160	379105
2. Gold	11072	10206	10487	11652	11652	11599	11598	11719
3. Direct investment	75480	82760	89878	101313	110078	124050	136809	145990
4. Corp. stocks	6573	7641	10537	10026	9011	9585	9453	10110
5. U.S. financial assets (line 1 - lines 2,3,4)	72260	78397	87792	99439	124978	149866	189300	211286
6. Foreign assets in U.S.	106912	133493	161658	174536	196988	220860	263582	306364
7. Direct investment	13270	13914	14868	20556	25144	27662	30770	34595
8. Stocks	27209	30811	39059	33516	24221	35638	42949	39779
9. Foreign financial assets (line 6 - lines 7,8)	66433	88768	107731	120464	147623	157560	189863	231990
10. Financial net (line 5 - line 9)	5827	-10371	-19939	-21025	-22645	-7694	-563	-20704

SOURCES: The DOC asset levels were taken from Russell B. Scholl, "The U.S. International Investment Position in 1985," *Survey of Current Business*, June 1986, Table 2, p. 28.

Brazil owe money primarily to commercial banks.¹⁷ As explained above, the negative U.S. net international investment position is presumed to be the result of many factors, predominantly foreign funds sent to the United States for safekeeping and high returns.¹⁸ Thus, there is a sharp difference in the nature of the debt positions.

In concluding the comparison of the United States and the LDCs, there is one similarity. Both the United States and LDCs have to make interest payments on the "financial" portions of their debts. The issue of interest payments relates to the concern that the U.S. standard of living will fall as the United States sends more dollars overseas. The popular press in the United States has voiced this concern.

¹⁷The Washington Post, "Editorial," July 31, 1986, p. A24.

¹⁸Ibid.

Table 9
U.S. NET FINANCIAL POSITION, 1978-1986, USING
DEPARTMENT OF COMMERCE DATA
(In millions of U.S. dollars, year end)

Item	1978	1979	1980	1981	1982	1983	1984	1985	1986
1. U.S. assets	447847	510563	606867	719687	824875	874053	898187	949371	1067888
2. Gold	11671	11172	11160	11151	11148	11121	11096	11090	11064
3. Direct investment	162727	187858	215375	228348	207752	207203	212994	229748	259890
4. Corp. stocks	11236	14834	19166	17661	18974	26551	27926	39839	50904
5. U.S. financial assets (line 1 - lines 2,3,4)	262213	296699	361166	462527	587001	629178	646171	668694	746030
6. Foreign assets in U.S.	371730	416106	500830	578983	688675	785559	893803	1061253	1331452
7. Direct investment	42471	54462	83046	108714	124677	137061	164538	184615	209329
8. Stocks	42097	48318	64569	64626	76762	97256	95836	124133	167440
9. Foreign financial assets (line 6 - lines 7,8)	287162	313326	353215	405643	487236	551242	633429	752505	954683
10. Financial net (line 5 - line 9)	-24949	-16627	7951	56884	99765	77936	12742	-83811	-208653

SOURCES: The 1978-1984 DOC asset levels were taken from Russell B. Scholl, "The U.S. International Investment Position in 1985," *Survey of Current Business*, June 1986, Table 2, p. 28. The 1985 and 1986 asset levels were obtained from Russell B. Scholl, "U.S. Net International Investment Position, 1986," *Department of Commerce News*, June 23, 1987. The 1985 numbers are revised, while the 1986 numbers are preliminary.

However, the U.S. standard of living, which is determined by the volume of goods and services that the United States consumes, will fall when foreigners don't want our dollars anymore and we can't buy as many of their goods and services. Thus, when the United States begins to experience a current account surplus and the capital account also turns around, the standard of living will be affected. At present, the current account deficit and the falling net international investment position indicate an elevated standard of living. In conclusion, the interest burden will not reduce the standard of living unless the United States encounters the LDC type of situation where a current account surplus becomes necessary to generate payments. Furthermore, the severity of the burden is still quite different between the United States and the LDCs.

Other concerns are that the potential vulnerability of the United States to future shocks will increase as a result of increased foreign exposure; that increased foreign exposure will constrain U.S.

authorities in their ability to have an impact with policy; and that the United States will become a hostage to the whims of foreign investors. Whether foreign investors hold American investments reflects rather than causes fundamental problems in the U.S. economy. Furthermore, the whims of U.S. investors are as potentially destabilizing as the whims of foreign investors. One should consider the percent of total investment that foreign investment represents. The vulnerability of the investment and exchange markets would depend on the magnitude of the foreign investment and on the elasticity of demand and supply in these markets. Since the announcement of the negative net international investment position of 1985, capital inflows have continued. This suggests that confidence in dollar-denominated assets has not fallen, and that pessimism is not necessarily well-founded.

Regarding the negative international investment position and the value of the dollar, no relationship has been observed between the assets and liabilities levels themselves and the exchange and interest rates. However, capital flows do have an impact on these rates. Specifically, increased demand for dollar-denominated assets will tend to cause the dollar to appreciate.

In considering the international investment position, not only is the position itself important, but also the composition of the position, the rate of change of the position, and the direction of that change. Generally, the United States is not worse off in welfare terms when foreigners invest here. To the extent that equity holdings do not bring predetermined fixed servicing burdens with them, they do not represent a vulnerability in terms of servicing and principal repayment burden. As mentioned earlier, their inclusion in the full balance sheet definition of debtor can be questioned. However, within that definition, increased foreign direct investment in the United States leads to a decline or deterioration of the net balance. Nevertheless, there are benefits from this element of the position. For example, in the past, direct investment has been a principal means of introducing new products and new technologies into the U.S. market.¹⁹ Second, a high percentage of the staff employed in foreign direct investment operations generally consists of U.S. citizens.²⁰ Thus, a reallocation of employment to the United States occurs as a result of these firms. However, more recently, concerns over "investment frictions" have been voiced. These frictions can be the result of poor management, poor local relations, and fear by the local U.S. citizens of foreign control of the local

¹⁹"Foreign Investment in the United States: Policy, Problems and Obstacles," New York City: The Conference Board, 1974.

²⁰Ibid.

economy.²¹ The latter is not necessarily a well-founded fear because U.S. firms are able to vacate an area as easily as foreign firms. Whether increased foreign direct investment in the United States is viewed as a "deterioration" of the net international investment position, as opposed to a "decline," depends in part on these considerations.

Finally, concern has been voiced over the effect of the negative international investment position on U.S. relations with foreigners. Four topics could lead to strained international relations. First, in an era of concern over "competitiveness" and "fair trade" issues, the increased Japanese investment in the United States is not met with completely open arms.²² The appearance that Japan is buying up America with profits from "unfair" trade relations—whether it really is or not—could get blown out of proportion in political spheres.²³ A second criticism relates to the allocation of world investment. If the safe haven argument is valid, politically unstable countries will suffer capital flight. Thus development will be slowed in these countries. Third, the U.S. mix of loose fiscal policy with tight monetary policy leading to high interest rates is viewed by some as an inappropriate stimulus of foreign investment in the United States. Fourth, the issue of NATO burden-sharing has emerged. The issue is not the level of alliance defense provision but rather the division of the bill.

²¹Yergin, "Worrying About 'Investment Frictions'."

²²Ibid.

²³Ibid.

VII. CONCLUSIONS

This study demonstrates that a range of values is possible for the net asset position of the United States. The range is affected by the data used, the definitions of the components compiled, and the components selected. Thus, the definition of the term "debtor" is important. Furthermore, policymakers must consider not only the implications of the definition, but also the composition of the decline of the position.

This study differs from others on this topic because it attempts to revise the direct investment, gold, and financial claims components of the DOC international investment position. Furthermore, it divides the full balance net investment position into two sub-balances, nondebt and financial nets, to observe the impact of the framework on the debtor status.

The financial net became negative as early as 1971, and if this narrow definition of debtor is adopted, debtor status was achieved in that year. However, the definition of debtor generally adopted for the United States has been the DOC full balance net. The combined results of this study's revisions significantly alter the DOC position. Table 10 presents a comparison of the DOC full balance nets and the adjusted full balance nets. However, although the debtor status of the United States is eliminated in some years of the 1980s, the decline in the U.S. position is not significantly altered.

Table 10

U.S. INTERNATIONAL INVESTMENT POSITION, DEPARTMENT
OF COMMERCE AND ADJUSTED, 1983-1986
(In billions of U.S. dollars, year end)

Item	1983	1984	1985	1986
DOC full balance net, with gold	88.5	4.4	-111.9	-263.3
Adjusted full balance net, with gold	369.0	277.1	177.7	49.8

SOURCE: Table 6.

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